

BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN

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Application of Milwaukee Water Works, Milwaukee County,  
For Authority to Increase Water Rates

Docket No. 3720-WR-107

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**REBUTTAL TESTIMONY OF THOMAS F. SCHRADER**  
**May 14, 2010**

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1 **Q. Please state your name and who you represent today at this hearing.**

2 A. My name is Thomas F. Schrader. I am appearing here today as a concerned citizen who  
3 is a water customer of one of the wholesale customers of the Milwaukee Water Works.

4 **Q. What are your qualifications to serve as a witness?**

5 A. I have over 25 years of experience in the public utility industry, many of those years in  
6 senior management roles. Most relevant to this proceeding, I was President and CEO of  
7 Wisconsin Gas Company at the time it entered the water utility business and became a  
8 wholesale customer of the Milwaukee Water Works.

9 **Q. What is the purpose of your testimony?**

10 A. I am appearing to ask the Public Service Commission and its Staff to be especially  
11 vigilant in its review of all aspects of this proceeding: the overall cost of service, cost  
12 allocation, and ratemaking. Also, I encourage the Commission and Staff, in conducting  
13 their review and reaching a decision, to apply the fundamental principles of rate making  
14 which have been the hallmark of regulation in the State of Wisconsin.

15 **Q. Why do you believe the Public Service Commission needs to be especially vigilant in**  
16 **this proceeding?**

17 A. The City of Milwaukee appears to be methodically looking for every opportunity to  
18 collect revenues that it can direct to other, non-utility purposes. This can lead to

1 assigning costs to the utility that would otherwise be collected in taxes, attempting to  
2 justify the highest reasonable cost for individual cost elements, and increasing rates to  
3 customer categories based on what the market will bear rather than cost responsibility.

4 Further, the Commission should consider the potential ongoing risks of permitting  
5 utility earnings to be used as general purpose revenues by the City. Diverting utility  
6 earnings to non-utility City purposes can motivate deferring maintenance, reducing  
7 investment, or cutting expenses in any given year in order to generate revenues for other  
8 City, non-utility purposes. This potential will require continual PSC oversight of utility  
9 operations. If the Commission does permit Milwaukee Water Works to provide earnings  
10 to the City, I strongly urge the Commission to place a specific and strict limit on the  
11 dollars that can be paid from the utility to the City so it controls the potential for the City  
12 to exert pressure on the utility when the City needs revenues.

13 As a matter of public policy, if the City wants to supplement its general treasury  
14 with monies from its water customers, it should only do so only with respect to its City of  
15 Milwaukee customers. In that case, there would be a shifting of Milwaukee's tax burden  
16 from the property tax to the retail water rates that Milwaukee taxpayers pay. It is  
17 something quite different to have wholesale customers whose customers are not City  
18 residents or businesses subsidize Milwaukee's general treasury through wholesale water  
19 rates.

20 It is also important to recognize that Payment in Lieu of Taxes (PILOT) is already  
21 a significant revenue source for the City. One has to question the appropriateness and the  
22 fairness to water customers, especially customers who do not use other City services, of  
23 payments to the City beyond the PILOT.

1   **Q.    Why is Commission vigilance especially important to the wholesale customers?**

2    A.    The wholesale water customers are completely dependent on the PSC to protect them  
3       from discriminatory rates.

4               Wholesale customers do not have the power of the election process which serves  
5       as a check on utility practices in the traditional municipal water utility setting. In fact in  
6       this case, the reverse is true. Elected and appointed public officials will want to charge  
7       non-voting, wholesale customers as much as they possibly can in order to reduce the  
8       water rates for their constituents.

9               It would be discriminatory ratemaking to have contract water customers subsidize  
10      Milwaukee's general treasury through wholesale water rates.

11   **Q.    Do you have any points you would like to make about the cost of service study or the**  
12       **level of cost items?**

13   A.    Yes. While I will leave detailed comments on the cost of service study and the level of  
14       cost items to others, I know, from my experience as a utility executive, that even in well  
15       run organizations, there are substantial opportunities to reduce costs through restructuring  
16       work and business processes. From 1993 to 1997, Wisconsin Gas worked with  
17       employees to review its business processes. We achieved and sustained a 25 percent  
18       reduction in operating expenses while keeping consistently high customer satisfaction  
19       ratings.

20              A commitment to a similar effort should be made at the Milwaukee Water Works.  
21       It will not change the level of expenses today, but it might ensure that we are not back  
22       here again in two years looking at additional rate increases.

1 **Q. Are there specific principles of ratemaking which you think are particularly**  
2 **important for the Commission to consider in this proceeding?**

3 A. Before talking about specific ratemaking principles, it may be helpful to summarize the  
4 widely accepted principles for setting utility rates that are found in the Principles of  
5 Public Utility Rates, by James C. Bonbright, first published by the Columbia University  
6 Press in 1961. They can be summarized as follows.

- 7 • Rate attributes: simplicity, understandability, public acceptability, and feasibility
- 8 of application and interpretation;
- 9 • Effectiveness of yielding total revenue requirements;
- 10 • Revenue (and cash flow) stability from year to year;
- 11 • Stability of rates themselves, minimal unexpected changes that are seriously
- 12 adverse to existing customers;
- 13 • Fairness in apportioning cost of service among different consumers;
- 14 • Avoidance of “undue discrimination;” and
- 15 • Efficiency, promoting efficient use of energy and competing products and
- 16 services.

17 Of these, I would like to comment first on the fourth bullet regarding the “stability  
18 of rates themselves, minimal unexpected changes that are seriously adverse to existing  
19 customers.”

20 **Q. What is your concern regarding rate stability?**

21 A. I have been told that, if the proposed rates are approved, most wholesale customers could  
22 see an increase in their water costs greater than 20 percent and several could be subject to

1 rate increases greater than 50 percent. These wholesale customers are almost all water  
2 utilities that have retail water customers who will experience significant rate shock.

3 The wholesale water customers and their retail customers have a strong basis for  
4 believing that they are currently paying fair rates for their water supplies. After all,  
5 current rates are based upon prior PSC rate-setting, and for the most recent wholesale  
6 customers, the contract rates they now pay for water are consistent with those that were  
7 freely negotiated with the Milwaukee Water Works and approved by a vote of the  
8 Milwaukee Common Council, frequently after considerable debate.

9 If the Commission determines that a change in rate methodology which results in  
10 substantial changes in rate levels is justified, then the Commission should direct that the  
11 change in rate levels be introduced in steps over time, perhaps over several rate cases.  
12 Experience teaches that customers react to the amount of a rate increase more so than to  
13 the fact of a rate increase.

14 **Q. Are there other ratemaking principles which you feel are particularly important in**  
15 **this proceeding?**

16 A. Yes. I would also like to comment on the principles regarding “Fairness in apportioning  
17 the cost of service among different consumers” and “Avoidance of undue  
18 discrimination.”

19 The issues of cost allocation and discrimination are generally addressed by cost  
20 allocation studies and are founded on the principle of cost causality and responsibility for  
21 those costs. By and large, the wholesale water customers are incremental customers that  
22 were added to the Milwaukee Water Works system with very little expense. For the most  
23 recently added wholesale customers, all of the water system expenses that were incurred

1 were paid for by the wholesale customer as part of the service contract with the City.  
2 Setting rates as if the Milwaukee water system were built to serve wholesale customers is  
3 an unfair apportioning of system costs and shifts cost to wholesale customers.

4 This is not to say that the wholesale customers should not pay rates that include  
5 some contribution toward the embedded cost of the transmission facilities they use.  
6 However, it should be recognized that such rates reflect a social decision, rather than a  
7 cost justified decision, and that care needs to be taken to avoid undue discrimination.

8 Further, wholesale rates should not include any capacity or operating expenses  
9 related to water distribution. Since wholesale customers use only large transmission  
10 mains, they do not cause, and should not have responsibility for, distribution expenses.  
11 Charging wholesale customers any distribution expenses would shift costs from City to  
12 wholesale end-use customers.

13 A consequence of shifting costs to one set of customers and away from others is  
14 that it distorts the real cost of water and changes the price signals customers receive.  
15 This is contrary to the last principle, "Efficiency, promoting efficient use of energy and  
16 competing products and services."

17 **Q. Does that conclude your testimony?**

18 **A.** Yes, it does.